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False Claims Act enforcement risk for private equity investors

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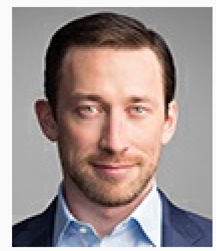

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The U.S. Department of Justice (DOJ) is using the False Claims Act (FCA)[1] to pursue private equity investors for alleged violations committed by portfolio companies.[2] While several case resolutions have become public, multiple ongoing cases remain confidential. This article describes recent FCA case settlements involving private equity and what proactive steps investors can take to protect themselves.

Private equity investors take substantial risk to provide capital when traditional lending institutions are unwilling to extend the credit necessary for businesses to innovate and expand. Any fair review of the role private equity plays in the healthcare economy must include consideration of the growth and enhancements in the delivery of care made possible by investors. During the COVID-19 pandemic alone, for example, private equity played an outsized role in the expansion of telehealth[3] and vaccine development.[4] While investors may be rewarded, casting private equity investors in a negative light is misguided. While some criticize private equity for profit-taking,[5] investors play a vital role in the development of new technology and expansion of the economy.

With a new era of heightened regulatory scrutiny and enforcement risk, investors should be aware that whistleblower attorneys who file qui tam suits on behalf of the United States are the main driver behind DOJ's investigations. These plaintiff attorneys have found a receptive audience in both legislative and executive branches of government,[6] and those branches are pressuring DOJ to bring more cases against private equity investors—a perceived deep pocket in FCA cases.

The False Claims Act

The FCA allows DOJ or whistleblowers, known as relators, to file suit to recover treble damages, per claim penalties, as well as legal fees and costs from companies that defraud the government. For 2022, FCA penalties can range up to $25,076 per claim.[7] Any time a qui tam suit is filed, DOJ must investigate the allegations.[8] Thereafter, DOJ has the option of intervening in and litigating the qui tam suit on behalf of the United States. As most companies that operate in the healthcare and life sciences sectors know well, there are hundreds of qui tam suits filed by whistleblowers every year.[9] DOJ declines to intervene in nearly two-thirds of these cases, and most of these are dismissed.

A private equity investor may have FCA liability where it "devises or implements" an unlawful scheme with the intent to defraud the government.[10] But the FCA goes further to penalize any individual or entity that *knowingly* presents, or causes to be presented, a false or fraudulent claim for payment or approval by the government.[11] The FCA also creates liability for any entity or individual that *knowingly* makes or uses, or causes to be made or used, a false record or statement in connection with a claim.

"Knowingly" means (a) actual knowledge, (b) deliberate ignorance, or (c) reckless disregard.[12] Reported caselaw is sparse, however, on what the "causes" standard means in the context of investors. We can expect whistleblowers and DOJ to take the broadest view imaginable—a view that can lead to liability where an investor is not aware of the wrongful conduct but still stands accused of failing to correct the gap in compliance or submission of false claims.[13]